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SUBJECT: TAIWAN INVESTMENT IN PRC - NOT JUST FOR EXPORT

Summary

[11.](#) (U) A survey of Taiwan enterprises in the PRC shows that 55 percent of their total output by value was sold within the PRC. More than half of those surveyed cited the expanding PRC domestic market as a primary reason for investing. In addition, the survey showed that 50 percent of inputs were purchased from Mainland sources, only 39 percent from Taiwan, and PRC financial institutions provided 34 percent of operational financing. This data undermines the assumption that the PRC is simply a cheap labor base for Taiwan companies. This more complex pattern of interaction means that the Taiwan and PRC economies are becoming far more integrated than previously thought. End summary.

Background on Survey

[12.](#) (U) To provide further information about Taiwan's investment in the PRC, the Ministry of Economic Affairs (MOEA), Investment Commission last year surveyed the Mainland enterprises of Taiwan firms regarding their activities in [12003](#). MOEA released the results in February 2005. MOEA surveyed 2,548 enterprises and received 817 usable responses. Survey questions covered a wide variety of topics, including investment motivation, sales destinations, input sources, and concerns about the investment environment. The survey provides useful information on Taiwan's investment, but the limited scope of the survey makes it more difficult to generalize about all of Taiwan's Mainland investment.

55 Percent of Sales to PRC

[13.](#) (U) Many analysts have observed that much of Taiwan's investment in the PRC is aimed at producing exports for markets in the U.S., Japan and Europe. The survey results reveal that many Taiwan investors are more interested in the domestic PRC market. Survey respondents reported that 55 percent of their sales went to the domestic Mainland market. Of the 45 percent exported, almost half went to Taiwan. In some industries, the PRC market accounted for almost all sales. In chemical products manufacturing, Taiwan enterprises sold 94 percent of their products within the PRC. In plastic products manufacturing the figure was 98 percent. Nevertheless, in electronics and electrical equipment manufacturing, the Mainland accounted for only a small portion of sales, some 15 percent. Exports to Taiwan consumed 53 percent of output for the industry, compared to 32 percent exported to other regions.

[14.](#) (U) Other data also indicated heavy interest in the domestic PRC market. Fifty-three percent of enterprises surveyed said that the expansion of domestic PRC demand was one of the main reasons they chose to invest in the Mainland -- the second most popular reason behind low labor costs at 83 percent. In comparison, a similar survey of firms with foreign investments in other regions showed that only 36 percent said that expansion of the local market was one of the main reasons they chose to invest. In addition, when enterprises that had seen higher profits during the survey year were asked why profit went up, 43 percent cited increases in local demand, the most frequently cited response.

PRC Important Source for Inputs and Finance

[15.](#) (U) According to the survey, the PRC is the largest source of inputs for Taiwan enterprises in the Mainland. Overall the survey showed that 50 percent of equipment, raw materials and parts was purchased from Mainland sources. In comparison, only 39 percent came from Taiwan. However, nearly half of the inputs purchased from Mainland sources, came from other Taiwan enterprises. Some key industries, including plastic products and electronics and electrical equipment manufacturing still rely more heavily on Taiwan sources, accounting for 50 percent and 46 percent of inputs respectively. Not surprisingly, imports from outside greater China, especially oil imports, were the most important source

of inputs for Taiwan-owned enterprises in chemicals manufacturing, making up 90 percent of total inputs.

16. (U) The PRC financial system is also an important source of financing for Taiwan enterprises in the Mainland. The survey indicated that PRC financial institutions were the source for 34 percent of operational financing, second only to the mother company in Taiwan at 37 percent. Taiwan financial institutions accounted for only 3 percent. In many industries, including basic metals, plastic products and chemicals manufacturing, PRC financial institutions were the largest source.

Comment - More Profound Integration

17. (SBU) These results cast new light on the nature of Taiwan's investment in the PRC. Many analysts have emphasized that much of Taiwan's investment is just export assembly, importing large quantities of parts from Taiwan for assembly in the PRC and sale to U.S., Japanese and European consumers. This pattern of investment would minimize Taiwan firms' interaction with the domestic PRC economy except as a source for cheap labor. The new data show that this is not the only story. While electronics manufacturing appears to fit this old model, Taiwan firms in other industries are increasingly selling to PRC consumers. They are also growing more dependent on Mainland sources for inputs and financing. Over time, this more profound integration may have an increasing impact on political cross-Strait relations. Taiwan will have more motivation to engage in a dialogue and regularize cross-Strait economic relations. End comment.

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